MANITOBA TELEPHONE SYSTEM
A member of Telecom Canada

Annual Report 1986-87

Established in 1908, The Manitoba Telephone System is a Provincially-owned Crown Corporation providing high-quality service and products to Manitobans for over 70 years.

Our Cover

Today's MTS network blends modern technology with the System's tradition of service to provide a wide range of voice, image and data transmission services linking Manitoba with the world.

THE MANITOBA TELEPHONE SYSTEM
489 Empress St., Winnipeg, Manitoba

Since 1908

ANNUAL REPORT

For the fiscal year ended March 31, 1987

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THE MANITOBA TELEPHONE SYSTEM

(as at March 31, 1987)

THE HONOURABLE GARY A. DOER
Minister Responsible for
The Manitoba Telephone Act

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Development*

ROBERT C. VANNEVEL
Vice-President
Corporate Services

GENERAL REGIONAL MANAGERS

ED TINKLER
Eastern Region

DOUG DELGATTY
Western Region

TED SCOLES
Northern Region

*Acting

HIGHLIGHTS 1986-1987

BUSINESS GROWTH

- Added 10,698 main telephones to the network to bring the System total to 512,984.
- Long distance calls increased 6.8% to a total of 91,575,000.
- Extended Area Service (EAS) is now available to 130,000 subscribers in 132 exchanges.
- Over 88.5% of all main stations are now served by ANI.

CONSTRUCTION

- Serviced 3,512 building lots representing 6,099 new dwelling units in Winnipeg.
- Installed a total of 174 km of fibre optics and began work on the Manitoba link of Telecom Canada's trans-continental fibre optic network.
- Fifteen rural exchanges were upgraded to digital switching.
- Over 83% of Manitoba households now have access to coaxial cable TV services.

FINANCIAL

	1987	1986
Capital Expenditures ...	$ 166,060,000	$ 153,154,000
Value of Telephone Plant	1,379,826,000	1,257,934,000
Operating Revenues	376,873,000	349,382,000
Operating Expenses	322,488,000	282,916,000
Other Revenues .	16,751,000	17,231,000
Debt Charges ...	91,127,000	84,735,000
Net (Loss)/ Revenue on Operations	(19,991,000)	(1,038,000)
Extraordinary Item	—	(27,110,000)
Net (Loss)/ Revenue for the Year	(19,991,000)	(28,148,000)

THE MTS DOLLAR (For The Year Ending March 31, 1987)

Where Each Dollar Came From:

Where Each Dollar Went:

LETTER OF TRANSMITTAL

The Honourable Gary Doer
Minister Responsible for The
Manitoba Telephone Act
Province of Manitoba

I have the honour to submit the Annual Report of The Manitoba Telephone System including financial statements for the fiscal year ended March 31, 1987.

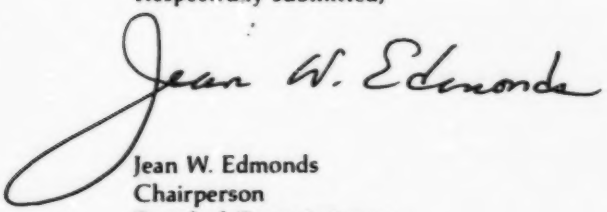
This report examines activities undertaken by the System's employees to improve the availability, range, and quality of telecommunications services to Manitoba subscribers.

It also describes the financial status of the corporation, including a report of a net loss of $19.9 million. The greatest portion of the net loss is attributed to the System's need to retire a large foreign debt issue in February 1987. This debt issue was denominated in Japanese yen, a currency that appreciated sharply in value against the Canadian dollar in 1986/87.

MTS met strong demands for service during the past year as a consequence of spirited economic development. Expanding residential housing developments and growth in the business sector, caused significant demand for basic service as well as special requirements from the business community. MTS also continued its commitment to improve service to rural and northern Manitobans by introducing digital technology to some fifteen exchanges throughout the province. These requirements, coupled with a general rise in inflation, resulted in increased operating and capital costs.

While addressing difficult service and financial pressure, the System began to lay the groundwork for major changes needed to improve its administrative, managerial and operational resources and practices. I am confident that this effort will ensure that The Manitoba Telephone System will continue to provide high quality service at reasonable rates to its customers throughout the province.

Respectfully submitted,



Jean W. Edmonds
Chairperson
Board of Commissioners
Manitoba Telephone System

OPERATIONAL REVIEW

Demand for business and residential telephone services continued to reflect the buoyant state of the Manitoba economy during the year from April 1, 1986 to March 31, 1987. A sound business environment coupled with affordable interest rates spurred business expansion and new housing starts which resulted in a total of 10,698 new main station installations during the year. Manitoba's total telephone population rose to 512,984, an increase of 2.1% over the previous year.

The MTS construction program kept pace with these increases in customer demand for new and improved communications services. Total construction expenditures rose 8.4% to a record total of more than $166 million to maintain the System's continuing network expansion and modernization programs.

Total revenues also reflected strong consumer demand for communications services increasing to $394 million from last year's total of $366.6 million. Revenue increases were achieved on local, long distance and miscellaneous services including directory advertising. Residential and small business sales revenues were particularly strong. They exceeded sales projections by 30% as a result of innovative marketing of a variety of new products and services. New telephones like the Citation™, Solo™, Signature™, Harmony™ and Uniden 1040™ which offer greater dialing convenience and ancillary services were particularly popular.

During the year under review, the System continued its commitment to modernize the telephone network. Telephone exchanges in the province are being converted to digital technology which provides greater operating efficiency, higher quality service and a wide range of specialized services such as Custom Calling.

At March 31, 1987, there were 17,000 Custom Calling services in operation, double the number in service 12 months earlier. In February, 1987, the System passed a milestone in residential Touch-Tone™ performance when it achieved 50% market penetration, the highest of any Canadian telephone company. Besides providing superior service quality, Touch-Tone™ generates additional System revenues.

During summer 1986, following a successful pilot project in the Thompson Business Office, a computer-based on-line system which provides access to records describing the location, type and service details for each telephone line, was extended to Flin Flon, The Pas and Morden. This Service Request System (SRS) allows service representatives to quickly provide customers comprehensive billing and service status information and allows direct entry of service orders to establish new telephone service, make changes or disconnects on customer moves. The system is now being used by 800 employees on 400 terminals in 40 centres around the province.

Long Distance services generated total revenues of nearly $212 million during the fiscal year, an increase of more than $14 million over 1985-86. Of this total, two-thirds was derived from inter-provincial and international revenue-sharing agreements with Telecom Canada member companies.

The average number of long distance calls placed daily within Manitoba rose from 235,000 in 1985-86 to 251,000 in the reporting year. This 6.8% increase is significantly below the 9.2% increase experienced during the previous year and represents a softening of the strong growth in long distance usage recorded over the past five years. This situation is a concern since long distance revenues are the key to ensuring the System's ability to maintain reasonable telephone rates for all Manitobans.

In March, 1986, the System adjusted its request to the Public Utilities Board and received approval for a 3% rate increase on all regulated Manitoba services. However, this increase was unable to keep pace with increases in operating expenses and foreign currency losses associated with retirement of long-term debt.

Despite a $27,011,000 increase in total revenues from 1985-86, the net loss for 1986-87 was $19,991,000 or 5.07% of total revenues.

The achievements detailed in this Report are but a few of the thousands of individual tasks and assignments completed by the 5,046 MTS people whose responses to market demand and dedication to providing quality service are the System's most important assets.

The MTS executive thanks staff throughout the province for their support and contributions during 1986-87.

FINANCIAL SUMMARY

The net loss for 1986-87 fiscal year was $19,991,000 compared with a net loss of $28,148,000 for the previous year.

Revenues from all sources amounted to $393,624,000, an increase of $27,011,000 over last year. Long distance service provided 56.2% of the System's operating revenues and at $211,717,000 was up $14,101,000 over 1985-86. Sixty-six percent of the System's long distance revenues were derived from calls made to points outside of Manitoba and undertaken in conjunction with the other member companies of Telecom Canada.

Revenues from local telephone services increased by $11,294,000 to reach $138,508,000. Miscellaneous revenues increased to $2,651,000 with a major portion attributed to directory advertising revenues. Other revenues totalled $16.8 million, a decrease of $480,000 from the previous year mainly attributable to lower interest revenues.

Depreciation of telecommunications property totalled $113,574,000 an increase of $15,057,000 compared to the previous year. Operations and administration costs amounted to $160,789,000 an increase of $14,492,000. Total operating expenses, excluding debt charges, increased $39,572,000 to $322,488,000.

Debt charges were $91,127,000 for the year, up $6,392,000 from 1985-86. Debt charges consist of interest on long term debt of $71,979,000 or $6,494,000 more than the previous year; unrealized and realized foreign currency losses of $2,902,000 and $14,350,000 respectively, including a realized loss of $12,472,000 on maturity of a bond denominated in Japanese yen; and other interest expense and debt charges equalling $1,896,000.

New long term borrowings during the year amounted to $217,192,000 in Province of Manitoba advances. Long term debt of $131,329,000 was retired during the year, with $10,058,000 of the repayment being provided by the Sinking Fund. Contributions to the Sinking Fund of $8,584,000 were made as required under The Manitoba Telephone Act. During the year, the Board of Commissioners approved contributions to the Pension Reserve of $20,236,000.

New telecommunications property added during the year amounted to $166,060,000, an increase of $12,906,000 over the previous year. Total property values as at March 31, 1987, were $1,379,826,000 which represents an average investment in plant per main telephone of $2,690.

A YEAR OF STEADY GROWTH

During the 1986-87 fiscal year, MTS activities responded to the steady demand for telecommunications services from both the business and residential sectors.

The 2.1% increase in the System's main station population to a total of 512,984 telephones was a continuation of the steady growth and expansion that has characterized the telephone network for the past five years.

To support this continuing demand and improve existing services, capital expenditures totalled a record $166,060,000 and financed a comprehensive construction program including replacement of above-ground wire with buried cable, expansion of the System's provincial fibre optic network and upgrading facilities to meet the service demands of the future. At year end, the System's total capital inventory totalled nearly $1.4 billion.

During the year, Manitobans placed an average of more than 5 million local calls daily. Revenues from local services increased by $11,294,000 to total $138,508,000. At the same time, total long distance calls placed exceeded 91.6 million and generated $211,717,000, or $14.1 million more than than in 1985-86.

Measures to improve customer service and reliability represented a major part of the 1986-87 program. In Winnipeg, more than 80 km of deteriorating lead-covered cable was replaced to improve service levels and reduce outages during periods of inclement weather.

CUSTOMER SERVICES

Residential

Housing starts in Winnipeg reflected the increased vigor of Manitoba's home construction industry and created strong demand for new residential telephone services. In Winnipeg alone, MTS crews serviced 3,512 new residential building lots providing facilities for more than 6,000 new dwelling units. This represents a 16% increase in building starts over the previous year.

The System is committed to upgrade existing switching equipment to digital technology by the year 2000. In 1986-87, fifteen more communities throughout the province were converted. Digital technology, offering new levels of reliability, speed, convenience and access to a variety of Custom Calling services, is now available to over 30,000 subscribers in smaller centres and 82,000 in Winnipeg.

Automatic Number Identification (ANI) which eliminates the need to give one's telephone number to an operator when placing direct-dialed long distance calls was extended to 17 more exchanges. This brought the total number of ANI-equipped exchanges to 127 and extended the service to 88.5% of the stations in Manitoba.

In the north, major service improvements, including installation of a second public telephone, were made at Brochet, Lac Brochet, Tadoule Lake and Shamattawa. Two northern communities — Snow Lake and Cross Lake — received the first digital switches to be installed in MTS's Northern Region and now have the most modern telecommunications system available.

Extended Area Service, enabling subscribers in one exchange to enjoy toll-free calling to another exchange, was implemented in nine cross-sections serving 26,000 customers in 18 exchanges. This popular service is now available to over 130,000 customers in 132 exchanges. At the same time, four existing EAS cross-sections received additional trunking capacity to provide improved EAS service quality.

Consolidation of Phone Centers in the MTS Head Office Building and the Unicity Mall to the Polo Park Shopping Centre, Manitoba's pre-eminent regional super-shopping mall, was one of a number of major Phone Centre upgrades carried out during the year. The redesigned and refurbished facilities provide an appealing and convenient retail atmosphere to showcase MTS products and services.

Business

During the 1986-87 fiscal year, the corporation generated the highest teleconferencing revenues within Telecom Canada and established Manitoba as a Canadian leader in the use of this innovative telecommunications system. Interest in the service was underlined by a $2.5 million Richardson Greenshields teleconferencing contract negotiated during the reporting period.

MTS joined other Telecom Canada companies in introducing a family of new digital services which offer major telecommunications customers the ability to consolidate their total telecommunications requirements in one package. These services, marketed as MegaPlan™, enable large-volume data customers such as financial institutions to improve their telecommunications efficiency and security by incorporating voice, data and image applications for transmission via Telecom Canada's national digital network facilities.

DataPac, a service that allows customers to transmit small volumes of information using a shared network, continued to receive strong market acceptance during 1986-87. Access to the DataPac network was expanded to low-volume users through an arrangement whereby the service is available directly on a dial basis from all Manitoba locations. This was particularly well-received by a number of schools in remote northern communities which are now linked to a central database offering a wide variety of interactive computer programs on a dial-up basis. Using the new dial-in DataPac network, these schools can provide students access to computerized learning programs at a fraction of the cost of maintaining individual personal computers in each location.

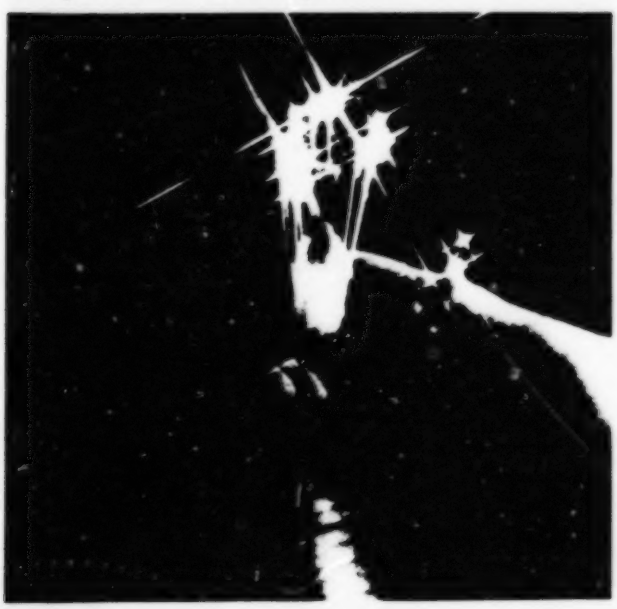
Digital Switching

In the short but dramatic evolution of the telephone from a simple voice transmission device to a versatile gateway to a virtually unlimited selection of sophisticated telecommunications services, no single development has had as much impact on the industry as the introduction of digital technology.

MTS is committed to a province-wide upgrading of the network to digital switching and has set the year 2000 as the target date for completion of the conversion. At that time, MTS will be an integral part of an international data communications network capable of handling computer transmissions as quickly and reliably as voice is handled today.

During the 1986-87 fiscal year, 15 more rural exchanges serving 25,500 customers in Minnedosa, Clear Lake, Dauphin, Fork River, Snow Lake, Cross Lake, Steinbach, Lorette, Niverville, La Broquerie, Grunthal, Kleefeld, Landmark, Inwood and Winnipeg Beach were equipped with this modern, reliable and versatile technology at a cost of $7 million. During the same period, the benefits of digital technology were extended to 82,160 more Winnipeg subscribers.

Digital switching offers the convenience of direct overseas and Operator-plus dialing and optional Custom Calling features such as call forwarding, speed calling, call waiting and three-way calling, features that provide new revenue potential.



Digital switching's tremendous potential lies in its ability to "speak" computer language and be upgraded and expanded quickly to meet customer needs. Because it can handle larger volumes of information at higher speed with greater reliability than conventional switching equipment, digital switching is more cost effective. This enables MTS to provide more sophisticated services province-wide at reasonable cost.

Fibre Optics

Just as digital switching has opened new vistas of telecommunications speed, versatility and reliability, fibre optics, thinner than a human hair, have revolutionized telecommunications transmission systems.

During 1986-87, a total of 174 km of fibre optic cable was installed in various Manitoba communities, including a 60-fibre cable in downtown Winnipeg to serve customers requiring high-capacity fibre optic facilities. (This cable is able to accommodate up to 150,000 simultaneous conversations.)

At the same time, MTS construction crews began fibre optic cable installation on the Manitoba portion of Canada's first coast-to-coast fibre optics transmission network. The 7,000 km project, which represents an investment of hundreds of millions of dollars by Telecom Canada member companies, will eventually replace the familiar microwave relay towers that presently dot the Canadian landscape.

MTS and Telecom Canada are sharing the

estimated $24 million cost of the Manitoba portion of the network. The inch-thick cable contains 14 fibres, eight of which will carry cross-country voice and data communications. The remaining six fibres are reserved for the System's use to improve telephone service within Manitoba.

Local fibre optic cable systems which will eventually link with the transcontinental network were installed during 1986-87 between Lorette and Landmark, Lac du Bonnet and Point du Bois, Anola and Hazelridge, Warren and Stonewall and Carman and Roland to bring new levels of transmission quality, flexibility and efficiency to these communities as work on the transcontinental network brings fibre optic technology within their reach.

Broadcast Services

In January, 1987, MTS and Winnipeg Videon Inc. concluded an agreement paving the way for the cable company to undertake an $11 million upgrading of the CATV network in Videon's operating territory west of the Red River. The project will increase the number of available channels from 14 to 35 and allow Videon to offer a wider range of Canadian discretionary channels such as The Sports Network, Much Music, Arts and Entertainment, The Learning Channel and specialty services such as home shopping.

MTS continued its role as common carrier for television service throughout Manitoba under agreements with 16 licensed CATV operators.

Local Broadband Networks were installed in 22 more communities. Residents of Ile-des-Chenes, Lorette, Miami, Plum Coulee, Holland, St. Adolphe, St. Jean, St. Claude, Notre Dame, West St. Paul,

Teulon, Pine Falls, Powerview, St. Georges, Erickson, McCreary, Shoal Lake, Rossburn, Glenboro, Hamiota, Elkhorn and Cranberry Portage now receive more varied television programming.

With these additions to the cable network, more than 255,000 subscribers, 83% of Manitoba households, now have access to the broadband cable network.

ADMINISTRATION

On November 21, 1986, Edward J. Robertson, formerly Deputy Minister, Industry, Trade and Technology, was named Acting President/Chief Executive Officer; Dennis Wardrop assumed the position of Acting Executive Vice-President; and Heather Nault was appointed Acting Vice-President — Corporate Marketing and Development. These appointments were to remain in effect until permanent officers could be selected. William Fraser, formerly Comptroller for the Province of Manitoba, was appointed Acting Vice-President — Finance on November 21, 1987. He was confirmed as Vice-President — Finance on March 16, 1987.

Two senior management changes involving long service employees occurred during the reporting period. On September 15, 1986, Ed Tinkler was appointed General Regional Manager — Eastern Region replacing Keith Axford who had retired on August 29, 1986, after 39 years of MTS service. On April 11, 1986, Ross Burns retired as Personnel Manager after more than 40 years of service and was succeeded by John Milne on July 28, 1986.

Five senior Regional appointments were made during the 1986-87 fiscal year. In Eastern Region, Gordon Smith became Area Manager at Portage and Bob McClintock was appointed Area Manager at Selkirk; in Western Region, Bob Geyson and Alvin Meakin were named Area Managers at Brandon and Dauphin, respectively; and in Northern Region, Ian Leslie became Area Manager at Thompson

During the fiscal year, in accordance with provincial pay equity legislation, MTS began the process of implementing pay equity. Pay equity is a compensation practice which is based primarily on the relative value of the work performed, regardless of gender. A joint union/management committee, under the direction of a newly appointed Pay Equity Officer, Irene Groot-Koerkamp, began selecting a single gender-neutral job evaluation system and identifying the gender-dominated job classes within the organization. Commencing in 1988, pay equity wage adjustments will be phased in over a four-year period. When this process is completed, any differences in the wages paid to male and female employees who are performing work of equal or comparable value will have been eliminated.

On March 31, 1987, a total of 5,046 full and part time people were employed by the System in some 80 communities around the province.

ACKNOWLEDGEMENTS

The Board of Commissioners recognizes with thanks the contributions of Edward J. Robertson, Dennis H. Wardrop, Heather J: Nault and William C. Fraser who agreed to serve as interim executive officers following the November, 1986, reorganization of the executive. Their support and experience during the transition were critical in maintaining customer and employee faith in the corporation's ability to provide quality telecommunications services.

MTS also recognizes and thanks the 1,800 members of The Telephone Pioneers of America, Chapter 50. Their enthusiasm and energy in carrying out a variety of voluntary community projects to assist people with disabilities bring credit to all involved in the telephone industry.

The Commissioners and Officers also express their sincere appreciation to employees at all levels within the System whose diligence, perseverance and dedication enabled MTS to maintain its tradition of quality service to Manitoba during a period when the System underwent unprecedented public scrutiny. Their contributions to MTS and the telephone industry are gratefully acknowledged.

FINANCIAL STATEMENTS

MANAGEMENT'S REPORT

The integrity and objectivity of the financial statements and accompanying notes in the annual report are the responsibility of management.

To fulfill this responsibility, The Manitoba Telephone System maintains internal control systems to provide reasonable assurance that the books and records, from which the financial statements are derived, accurately reflect all transactions and that established policies and procedures are followed. The internal control systems are supported by regular reviews by internal auditors and by examination of the financial statements by Arthur Andersen & Co., independent chartered accountants.

The responsibility of the Board of Commissioners for the statements is pursued principally through its Audit Committee, which meets periodically with management and the internal and external auditors, to review accounting controls, results of audits and accounting principles and practices.

The external auditors have full access to the Audit Committee both with and without management present. Their report, which provides an independent review of the system of internal controls and the compliance of the statements to generally accepted accounting principles, follows.

On behalf of the management:

President and Chief Executive Officer

Vice President — Finance

ARTHUR ANDERSEN & CO.
CHARTERED ACCOUNTANTS

AUDITOR'S REPORT

To the Board of Commissioners of
The Manitoba Telephone System:

We have examined the balance sheets of THE MANITOBA TELEPHONE SYSTEM (a Manitoba corporation) as at March 31, 1987 and 1986 and the related statements of operations and reinvested earnings and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these financial statements present fairly the financial position of the company as at March 31, 1987 and 1986 and the results of its operations and the changes in its financial position for the years then ended in accordance with the basis of accounting described in note 1(a) applied on a consistent basis.

Arthur Andersen & Co.
Chartered Accountants

Winnipeg, Canada
June 19, 1987

THE MANITOBA TELEPHONE SYSTEM

BALANCE SHEETS MARCH 31, 1987 AND 1986

ASSETS

	1987	1986
	(in thousands of dollars)	
		(Note 13)
TELECOMMUNICATIONS PROPERTY		
Buildings, plant and equipment	$1,319,590	$1,188,459
Less accumulated depreciation	642,123	571,517
	677,467	616,942
Land	6,018	5,870
Materials and supplies, at cost	17,462	15,456
Plant under construction	36,756	48,149
	737,703	686,417
INVESTMENTS (Note 2)	999	999
PENSION RESERVE (Notes 8 and 11)	52,251	70,250
CURRENT ASSETS		
Temporary cash investments	48,172	7,482
Accounts receivable	45,350	44,261
Prepayments	5,035	4,654
	98,557	56,397
DEFERRED CHARGES		
Unrealized foreign currency losses, net of amortization	20,466	30,230
Unamortized long-term debt expenses	4,789	4,202
Preliminary engineering and miscellaneous	3,241	3,186
Deferred employee benefit costs, net of amortization	2,078	2,493
	30,574	40,111
	$ 920,084	$ 854,174

Approved on behalf of the Board

Vice-Chairperson

Commissioner

The accompanying notes are an integral part of these balance sheets.

THE MANITOBA TELEPHONE SYSTEM

BALANCE SHEETS MARCH 31, 1987 AND 1986

LIABILITIES AND REINVESTED EARNINGS

	1987	1986
	(in thousands of dollars)	
		(Note 13)
DEBT		
Long-term debt (Note 9)	$ 753,325	$ 690,151
Less sinking fund investments, at cost	51,013	52,488
	702,312	637,663
Notes payable	5,000	5,000
	707,312	642,663
REINVESTED EARNINGS	67,563	87,554
DEFERRED EMPLOYEE BENEFITS (Note 11)	66,967	46,191
CURRENT LIABILITIES		
Outstanding cheques less cash in bank	817	1,505
Accounts payable and accrued liabilities	51,068	43,078
Advance billings and payments	4,137	3,791
Accrued interest	20,980	18,827
Provision for loss on wind down of subsidiary (Note 3)	1,240	10,565
	78,242	77,766
COMMITMENTS (Note 10)		
CONTINGENCIES (Note 3)		
	$ 920,084	$ 854,174

THE MANITOBA TELEPHONE SYSTEM

STATEMENTS OF OPERATIONS AND REINVESTED EARNINGS FOR THE YEARS ENDED MARCH 31, 1987 AND 1986

	1987	1986
	(in thousands of dollars)	
		(Note 13)
OPERATING REVENUES:		
Long distance service	$211,717	$197,616
Local service	138,508	127,214
Miscellaneous (Note 4)	29,094	26,443
Less uncollectible operating revenues	(2,446)	(1,891)
	376,873	349,382
OPERATING EXPENSES:		
Operations and administration	160,789	146,297
General	39,489	30,102
Depreciation	113,574	98,517
Operating taxes	8,636	8,000
	322,488	282,916
NET OPERATING REVENUES	54,385	66,466
OTHER REVENUES (Note 6)	16,751	17,231
NET REVENUES BEFORE DEBT CHARGES	71,136	83,697
DEBT CHARGES (Note 7)	91,127	84,735
NET LOSS BEFORE EXTRAORDINARY ITEM	(19,991)	(1,038)
EXTRAORDINARY ITEM (Note 3)	—	(27,110)
NET LOSS FOR THE YEAR	(19,991)	(28,148)
REINVESTED EARNINGS, beginning of year	87,554	115,702
REINVESTED EARNINGS, end of year	$ 67,563	$ 87,554

The accompanying notes are an integral part of these statements.

THE MANITOBA TELEPHONE SYSTEM

STATEMENTS OF CHANGES IN FINANCIAL POSITION FOR THE YEARS ENDED MARCH 31, 1987 AND 1986

	1987	1986
	(in thousands of dollars)	
		(Note 13)
CASH PROVIDED BY (USED FOR) OPERATING ACTIVITIES:		
Net loss for the year	**$(19,991)**	$ (28,148)
Cash provided (used) by changes in working capital (Note 12)	**(306)**	1,405
Add: Depreciation and other items not requiring cash, net	**118,098**	138,890
Payment toward deferred employee benefits	**(1,019)**	(645)
Total cash provided by operating activities	**96,782**	111,502
CASH PROVIDED BY (USED FOR) FINANCIAL ACTIVITIES:		
Long-term debt	**217,192**	160,655
Notes payable	**5,000**	5,000
Repayment of bonds and advances	**(131,329)**	(62,167)
Repayment of notes payable	**(5,000)**	(31,225)
Total cash provided by financial activities	**85,863**	72,263
CASH PROVIDED BY (USED FOR) INVESTMENT ACTIVITIES:		
Withdrawals from pension reserve	**38,235**	4,185
Sinking fund withdrawals	**10,058**	4,280
Contribution to pension reserve	**(20,236)**	(29,005)
Contribution to sinking fund	**(8,584)**	(7,441)
Construction program expenditures, net	**(160,740)**	(151,074)
Increase in investments	**—**	(8,777)
Total cash used for investment activities	**(141,267)**	(187,826)
INCREASE (DECREASE) IN CASH AND TEMPORARY CASH INVESTMENTS	**41,378**	(4,061)
BALANCE, beginning of year	**5,977**	10,038
BALANCE, end of year	**$ 47,355**	$ 5,977

The accompanying notes are an integral part of these statements.

THE MANITOBA TELEPHONE SYSTEM

NOTES TO FINANCIAL STATEMENTS MARCH 31, 1987 AND 1986

1. SIGNIFICANT ACCOUNTING POLICIES

(a) General

The accompanying financial statements have been prepared in accordance with Canadian generally accepted accounting principles, except for the accounting for pension costs as set out in Note 11. The system of accounts and practices are similar to those used by other Telecom Canada members.

(b) Telecommunications Property

Telecommunications property is recorded at original cost including materials, direct labour and overhead costs which vary with the level of construction. In addition, the System includes the cost of funds used to finance the construction, based on the duration of the projects.

(c) Depreciation

Depreciation is calculated on a straight-line basis over the estimated useful life of telecommunications property by applying rates which are based on a continuing program of engineering studies.

When depreciable telephone property is retired, the original cost of such property, adjusted by any disposal proceeds and costs of removal, is charged to accumulated depreciation.

(d) Translation of Foreign Currencies

Foreign currencies have been translated into Canadian funds at rates of exchange on the following basis:

i) long-term debt at rates prevailing at year end;
ii) accrued interest at rates prevailing at year end;
iii) debt charges at rates prevailing at the date of each transaction.

The unrealized loss resulting from the policy of using rates prevailing at March 31 is being amortized over the remaining term of the debt.

(e) Deferred Employee Benefits

The deferred employee benefit liability represents a sick leave vesting (SLV) plan and pension provisions as outlined in Note 11. The initial cost of the SLV plan, which became effective June 1, 1977, is being amortized on a straight-line basis over fifteen years.

The annual sick leave entitlements subsequent to June 1, 1977 are being accrued and charged to expense in the year to which they relate. Payments to employees on termination are being charged to the deferred liability.

2. INVESTMENTS

	1987	1986
	(in thousands of dollars)	
Telesat Canada 99,900 common shares, at cost	$ 999	$ 999

3. PROVISION FOR LOSS ON WIND DOWN OF SUBSIDIARY

As at March 31, 1986 the investment in MTX Telecom Services Inc. (MTX), a wholly-owned subsidiary of the System, was written off in the amount of $27,110,000, and a provision for loss in the amount of $10,565,000 was established. In 1987, $9,325,000 was charged against this provision.

Other contingencies or claims may arise as MTX continues with the wind down of its operations. The nature and magnitude of such contingencies, if any, is not determinable at this time.

4. MISCELLANEOUS OPERATING REVENUE

	1987	1986
	(in thousands of dollars)	
Miscellaneous operating revenue includes:		
Directory advertising	$20,829	$18,588
Rentals and attachments	6,091	5,964
Other	2,174	1,891
	$29,094	$26,443

5. OPERATING TAXES

This category represents grants to municipalities in lieu of property taxes, the System's portion of Canada Pension Plan and Unemployment Insurance, the Health and Education Levy and general levies.

6. OTHER REVENUE

	1987	1986
	(in thousands of dollars)	
This group of revenue includes:		
Interest earned on investments	$12,091	$12,917
Surcharge on overdue accounts	1,983	1,675
Interest charged to construction	834	1,539
Net recoveries from foreign contracts	31	102
Miscellaneous, net	1,812	998
	$16,751	$17,231

7. DEBT CHARGES

	1987	1986
	(in thousands of dollars)	
Debt charges include:		
Interest on long-term debt	$71,979	$65,485
Amortization of unrealized foreign currency losses	2,902	10,960
Realized loss on foreign currency	14,350	6,263
Amortization of long-term debt expenses	970	815
Other interest expense and debt charges	926	1,212
	$91,127	$84,735

8. PENSION RESERVE

During the year, the Board of Commissioners approved contributions to the Reserve of $20,236,000 and withdrawals from the Reserve of $38,235,000. The Reserve is comprised of short-term investments held in trust by the Minister of Finance of the Province of Manitoba. Interest on the Reserve is recorded as income in the period it is earned.

The withdrawal of $38,235,000 was used in the retirement of Series 10J in the amount of $31,062,574 and to unfund the remaining foreign currency amortization of $7,172,426.

The Fund was renamed the Pension Reserve, following the removal of foreign currency amortization funds. The Pension Reserve was increased from $32,015,000 in 1986 to $52,251,000 in 1987.

9. LONG-TERM DEBT

	1987			1986
	Outstanding at rates prevailing March 31, 1987	Foreign exchange adjustment Note 1(d)	Outstanding at rates prevailing when debt incurred	Outstanding at rates prevailing when debt incurred
	(in thousands of dollars)			
Province of Manitoba Advances				
Series 10J, 8¾%, due February 28, 1987 (6.3 billion Japanese Yen)	$ —	$ —	$ —	$ 23,213
Series 11M, 13¼%, due October 13, 1987	65,000	—	65,000	65,000
Series 10V, 9¾%, due December 1, 1988	25,000	—	25,000	25,000
Series 11E, 14¾%, due July 1, 1991 (40.0 million U.S. Dollars)	52,204	4,242	47,962	47,962
Series 11J, 15¼%, due March 31, 1992	40,000	—	40,000	40,000
Series 10T, 9¾%, due May 15, 1998	12,090	—	12,090	12,090
Series 11A, 10¼%, due August 1, 1999	5,000	—	5,000	5,000
Series 9X, 10%, due December 5, 1999	10,000	—	10,000	10,000
Series AD, 10⅝%, due May 15, 1986	—	—	—	65,000
Series AN, 11½%, due May 15, 1995	50,000	—	50,000	50,000
Series AX, 7½%, due May 20, 1996 (46,372,650 U.S. Dollars)	60,521	(3,571)	64,092	—
Series BC, 8½%, due February 5, 1997	87,500	—	87,500	—
Series UFA1, 11%, due November 5, 1995	55,000	—	55,000	55,000
Series UFA2, 9 13/25%, due September 26, 1996	65,600	—	65,600	—
Interim Advance, 10%, due June 25, 1986	—	—	—	6,815
Interim Advance, 10%, due September 29, 1986	—	—	—	23,800
	$527,915	$ 671	$527,244	$428,880
Bonds Payable				
Debentures issued by the System fully guaranteed by the Province				
Series 1C, 5½%, due December 2, 1986	$ —	$ —	$ —	$ 12,500
Series 1J, 7¾%, due February 15, 1989	10	—	10	10
Series 1M, 8%, due September 15, 1989	108	—	108	108
Series 1E, 5%, due January 15, 1991 (14.5 million U.S. Dollars)	18,924	3,344	15,580	15,580
Series 1N, 7⅞%, due November 15, 1991	20,000	—	20,000	20,000
Series 1F, 6¼%, due December 1, 1991	20,000	—	20,000	20,000
Series 1G, 7%, due February 15, 1993	20,000	—	20,000	20,000
Series 1P, 7⅞%, due March 15, 1993	10,000	—	10,000	10,000
Series 1T, 10%, due July 2, 1995	10,000	—	10,000	10,000
Series 1U, 10½%, due May 1, 1996	20,000	—	20,000	20,000
Series 1S, 8¾%, due March 1, 1999	37,000	—	37,000	37,000
Series 1V, 5%, due January 3, 1992 (80.0 million Swiss Francs)	69,368	15,088	54,280	54,280
	$225,410	$ 18,432	$206,978	$219,478
	$753,325	$ 19,103	$734,222	$648,358
Foreign Exchange Adjustment				$ 41,793
Outstanding at Rates Prevailing March 31, 1986				$690,151

Under the requirements of The Manitoba Telephone Act, the System is required to pay to the Minister of Finance of the Province of Manitoba, as trustee for the sinking fund, an amount which is not less than 1% of the long-term debt outstanding at the end of the preceding fiscal year and 4% of the sinking fund balance at the end of the preceding fiscal year. The market value of the investments held in the fund at March 31, 1987 is $56,343,125 (1986 - $56,517,557).

If the System incurs no new long-term debt and assuming exchange rates at March 31, 1987 remain unchanged, the following payments will be required to meet sinking fund conditions and debt retirements:

Year ending March 31	Sinking fund payments	Debt retirement
	(in thousands of dollars)	
1988	$9,383	$ 65,000
1989	8,967	25,010
1990	8,956	108
1991	9,312	18,924
1992	9,236	201,572

10. COMMITMENTS

The Manitoba Telephone System rents buildings and construction and other equipment under operating leases. The aggregate annual rental of the commitments under the leases, which expire at varying dates to March 31, 1992, are:

1988	$2,404,786
1989	1,147,424
1990	502,916
1991	319,585
1992	166,818

11. PENSION

Employees of the System are pensionable under the Civil Service Superannuation Fund and make contributions at prescribed rates. The System is required to pay 50% of the Fund's pension disbursements made to retired employees. The payments are charged to general, operations and administration expenses as incurred.

An actuarial evaluation of the Fund was conducted as at December 31, 1983. The results of the evaluation indicate that at the date of review the Fund was in a sound financial position.

According to the formula contained in the report issued after the evaluation, the liability which the System had at December 31, 1986 was:

(a) if no allowance is made for future increases in pension due to increases in the cost of living, $137,239,000.

(b) if allowance is made for future increases in pension due to increases in the cost of living, $213,210,700.

During the fiscal year ended March 31, 1984, a $5,000,000 provision was made to recognize the System's liability as a result of implementing an early retirement program and from legislated changes to the Pension Benefits Act. This provision has been augmented by $47,251,000 for the years ended March 31, 1985 to March 31, 1987. The increase, included in general expense, represents additional provision for legislative changes to the Pension Benefits Act and a partial recording of the increased liability accrued during the year.

A cumulative amount of $52,251,000 has been included in contributions made to the Pension Reserve on account of pension liabilities.

12. STATEMENTS OF CHANGES IN WORKING CAPITAL

Cash was provided (used) by changes in working capital as follows:

	1987	1986
	(in thousands of dollars)	
Increase in Current Assets:		
Accounts receivable	$(1,089)	$(5,958)
Prepayments	(381)	(300)
Increase (Decrease) in Current Liabilities:		
Accounts payable and accrued liabilities	7,990	(3,951)
Advance billings and payments	346	482
Accrued interest	2,153	567
Provision for loss on wind down of subsidiary	(9,325)	10,565
	$ (306)	$ 1,405

13. RECLASSIFICATIONS

The 1986 figures have been reclassified where necessary to conform to the 1987 presentation.

THE MANITOBA TELEPHONE SYSTEM

FIVE YEARS IN REVIEW
FOR THE YEARS ENDING MARCH 31

STATEMENT OF OPERATIONS (in thousands of dollars)	1987	1986	1985	1984	1983
Total operating revenues	$ 376,873	$ 349,382	$ 326,330	$ 294,248	$262,268
Total operating expenses	322,488	282,916	265,443	243,496	214,728
Other revenues	16,751	17,231	15,283	15,509	14,273
Debt charges	91,127	84,735	60,978	64,134	58,306
Extraordinary item	—	27,110	—	—	—
Net (loss)/revenues	(19,991)	(28,148)	15,192	2,127	3,507
BALANCE SHEET (in thousands of dollars)					
Telephone Plant	$1,379,826	$1,257,934	$1,132,271	$1,037,519	$977,610
Accumulated depreciation	642,123	571,517	501,892	429,271	375,362
Investment and sinking funds	104,263	123,737	103,817	83,015	80,465
Government advances	527,915	462,992	346,410	370,403	365,121
Bonds payable	225,410	227,159	211,505	227,459	241,902
Construction expenditures	166,060	153,154	112,721	91,400	111,131
Reinvested earnings	67,563	87,554	115,702	100,510	98,383
TELEPHONE STATISTICS					
Plant investment per main telephone	$ 2,690	$ 2,504	$ 2,320	$ 2,200	$ 2,138
Main Sets in Service					
Business	103,080	101,085	94,627	88,385	81,336
Residence	409,904	401,201	392,813	383,507	375,812
Total	512,984	502,286	487,440	471,892	457,148
Percent dial	100.0	100.0	100.0	100.0	100.0
Main Telephones added during year	10,698	14,846	15,549	14,744	8,671
(a) Average daily local calls (in thousands)	5,342	4,910	4,562	4,224	3,908
(b) Average daily long distance calls (in thousands)	251	235	215	201	190
OTHER STATISTICS					
Salaries and wages (in thousands)	$ 146,978	$ 139,822	$ 129,012	$ 122,049	$114,549
Number of full and part time employees on March 31	5,046	4,899	4,660	4,537	4,499
Employees per thousand main telephones	9.8	9.8	9.6	9.6	9.8
Long-term debt percentage of total invested capital	91.0	87.5	82.0	84.2	84.7
Debt charge coverage ratio	.8	.9	1.3	1.0	1.1
Effective average debt rate	12.5	13.2	10.2	10.6	9.9

MANITOBA TELEPHONE SYSTEM
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